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London

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A modern democratic State needs a constantly increasing income in order to perform efficiently its public services. A portion of the required income may be derived from the sale of certain services, such as those rendered by the Post Office or the Railways, where these are in State hands, or in some countries from lands, mines, forests, and other public properties If the British State could acquire and operate, or lease on advantageous terms, our railways, mines, electric plant, and other services and industries hitherto left to private enterprise, it is possible that it might obtain considerable revenues from these remunerative services. After due consideration for the interests of the workers in these specific services, and of the consumers, some rents or profits might be available to defray part of the cost of the non-remunerative services, such as defence, police, public health, and education.

But, at any rate for some time to come, by far the greater part of the revenue of our State must be got by taxation. The legacy of debt left over by the war and the large immediate needs of social reconstruction make demands upon the State so heavy as to involve a revenue probably five times as large as the pre-war amount. This gives great urgency to the issue of a tax policy. Before the war, Labour concerned itself little with such matters, except to resist the threatened attack upon its standard of life by Tariff Reform. But there devolves upon the Labour Party now the double duty of resisting direct and indirect attacks upon the money or real wages of the workers, and of devising sound methods of raising, from sources possessing a true ability to bear taxation, the large tax-revenue that is needed.

Having regard to the present revenue requirements, which mount up to something like 1,000 millions, unless the bad foreign policy of the Government with its extravagant expenditure on armaments is reversed, it will be necessary to discover and to tap all available sources of taxation. Setting aside for the moment the emergency proposal of a Capital Levy,* and turning to the regular sources of annual taxation, we have first to bear clearly in mind the fact that such regular taxation must be derived from the income of the year, that is to say, it must direct from private to public possession a part of the year's product by taking through taxation the money that it represents.

WHO PAYS THE TAXES?

All ordinary taxation falls upon the income which individual citizens get from the labour of their brains or muscles, or from the rent, interest, and profits derived from the land and capital of which they are legal owners. Even where taxes are laid upon commodities and are said to fall on "the consumer," they do so by raising prices and so reducing the "real" income which his money income purchases for him.

In seeking to comprehend clearly processes of taxation, it is best to ignore the common distinction made between taxes borne by producers'

* See separate pamphlet, "*The Capital Levy*," by F. W. Pethick Lawrence, The Labour Party, 2d.

incomes and those borne by consumers, and to treat all taxes as being, what in the last resort they are, deductions from income. The reason for doing this is that it focuses our interest sharply upon the crucial issue, what incomes have and what have not an "ability to pay"?

ABILITY TO PAY

How badly this issue was realised even by so great a pioneer in Tax Theory as Adam Smith is seen in the first of his maxims which declares that "The subjects of every State ought to contribute towards the support of the Government as nearly as possible in proportion to their respective abilities; that is, in proportion to the revenue which they respectively enjoy under the protection of the State." If ability to pay is to be interpreted thus, then every citizen, whatever the size of his revenue or income, must make a contribution. This view is persistently expounded by well-to-do economists and publicists who attach to it a high moral value. "Every citizen who enjoys the protection and other services of the State should feel that he is making some direct personal sacrifice for the upkeep of this State."

Now this view rests on the false assumption that every owner of an income has "ability to pay." Now incomes which consist of payments necessary to sustain and to evoke the productive use of any factor of production have no ability to pay. Such elements of income are necessary costs of production and any attempt to put a tax upon them reduces productivity. The chief of these necessary costs is wages. The standard wage in an industry seldom exceeds what is required to enable the worker to maintain himself and his family in full economic efficiency. This physiologically necessary income may be said to have an absolute inability to bear taxation. For any tax which was laid upon it must, unless it were shifted, cause a reduction in the taxable body of wealth. Even where a standard wage contains some provision for conventional class comforts, any attempt suddenly to reduce it will have the same effect. It will either reduce the effective supply of labour and so reduce the product, or, if labour is strongly organised enough, it will force a rise in money-wages, which will shift the tax, either on to the employers' profits, or some other income with real ability to pay.

CAN WAGES PAY?

There are, no doubt, wage-incomes containing large recent increases, not yet firmly incorporated in a standard of life, which have some ability to pay. But, speaking generally, standard wages in such a country as Great Britain consist entirely of necessary costs of production, and any tax, direct or indirect, imposed upon them is a bad tax. Bad, if it lies, because it depresses production. Bad, if it is shifted, because the shifting process is wasteful, vexatious, and uncertain.

What is true of wages is true of certain other payments made to the owners of other factors of production. Where such payments, or incomes, are under existing circumstances necessary in order to evoke the full economic use of the factor, whether it be business or professional skill or capital, such income has not ability to bear taxation. Note the qualifying words "under existing circumstances." They apply both to the remuneration of capital and of brain labour in its more profitable spheres. So long as capital is supplied wholly or mainly by private

individuals out of that part of their income which they save, or do not spend, it will be necessary to secure to them some inducement in order to evoke this saving. No doubt a certain amount of saving would be made out of large incomes if interest sank to zero, but not enough for the quantity of fresh capital required by a nation with growing population and growing needs. So long, therefore, as industries are run by private enterprise, a minimum payment of interest is as economically necessary as a minimum wage. And it has the same inability to bear a tax.

The same applies to incomes paid to business men, professionals, officials, &c., whether the income be called profit, salaries, or fees, or wages of management. Most of the work done by these people is socially productive, and the minimum payments necessary to evoke and sustain it must be secured to them. These minimum payments are costs of production.

THE CAPITALIST'S "SURPLUS"

But the differences between the capacity of the wage-earners and the recipients of interest, profits, rents, and salaries to bear taxation is of vital significance. For, whereas almost the whole of wages is necessary to evoke the use of labour, the payments made for the use of land, capital, and the more remunerative kinds of ability contain elements of surplus, due to natural or contrived scarcity or to other favourable economic positions enjoyed by the recipients. It is unnecessary to dwell upon the incomes derived by land-owners under the form of rent. So far as rent consists of payment for the use of unimproved land, it is wholly surplus, and has entire "ability to pay," as all economists admit. So far as recent "improvements" are included, rent contains some element of interest, and a minimum interest, as we recognise, must rank as a "cost" without true ability to pay.

Though land-values contribute largely to the taxable surplus they cannot, as single-taxers contend, be treated as comprising that surplus. The greater part of the surplus in such a country as Britain consists of interest, profit, salaries, and fees, which exceed the payments necessary to evoke the use of the capital or ability that is involved. This surplus emerges at a thousand different points in the processes of bargaining for payment by which industry and commerce are conducted. This surplus, thus variously composed, may properly be regarded as an income which is social, in the sense that it has its origin in social conditions, is not required for the support of individual efforts, and constitutes a fund upon which the State may properly draw to support the social work it undertakes.

INCOME TAX AND DEATH DUTIES

But this distinction between "costs" and "surplus," though theoretically sound, does not furnish a simple practical basis of taxation. For the detection and measurement of the innumerable separate bits of surplus which enter into incomes are not feasible. Only in the case of land-values may it be possible to assess the surplus separately, and even there the fact that much property will have exchanged hands under conditions which have not distinguished it from other forms of property will make any special taxation seem

inequitable. On these and other grounds it is best to retain and improve the existing instruments of income-tax and death duties for securing as much of the surplus as the State requires. The defence of this policy rests upon the generally sound assumption that the larger an income is the larger the proportion of surplus it may be assumed to contain. The exemptions, deductions and allowances, progression and super-tax in our present system are an admission and a partial application of this principle. But a series of important reforms are needed to enable the income tax to do what is required.

THE EXEMPTION LIMIT

1. The exemption limit should be such as to exempt from all taxation the economic subsistence of the wage-earner, and should vary with variations in the price-level of the articles entering into that subsistence.

In order to make good this exemption, a more liberal interpretation should be given to those "expenses necessarily and exclusively incurred for the purpose of the employment" which are supposed to be taken into account in assessing wage-incomes for purposes of the income tax. In particular (1) Travelling expenses to and from work, and allowances for tools, clothing, and other items of cost incurred in connection with employment should receive more liberal treatment; (2) Trade Union contributions and sick and accident fund contributions should be deducted from taxable income.

FAMILY INCOMES

2. Since all income needed for the maintenance and improvement of a worker and his family ranks as costs, it is clear that the taxable surplus which any family income contains varies with the size and needs of the family. This justifies a large extension of the present inadequate allowances for wife and children by the adoption of the principle thus formulated by Mr. Sidney Webb, that "Family Incomes should, for income tax purposes, be divided by the number of members of the family (husband, wife, children, step-children, father, and mother, or grandparents only) actually maintained therefrom. There could then be allowed from the combined Family Income, in respect of the persons maintained therefrom, whatever abatement each portion of such income would justify if it were that of one person only."

A CURVE OF VALUATION

3. With these provisions made for the lower grades of income, it would be well to do away with the allowances, abatements, and super-tax of the present system, and replace them by a single progressive curve of valuation, according to which every taxed income would pay a different rate of taxation according to its size. The present method contains two grave faults. The first is the sudden jumps in the tax-rate at a number of arbitrary points in the rise of taxable income. Each of these sudden jumps arouses a sense of grievance and evokes under-declaration of income, especially in the lower level of incomes, where the jumps are greatest. The second fault is the slowing down of the rate of progression in the higher incomes. While a rate of 9s. in the £ is reached at £14,000, the rate at £40,000 is only 10s., and at £150,000 the maximum rate is no more than 10s. 4d. Since almost the whole of the highest grades of income is pure "surplus" this depression and

ultimate stoppage of the rise in tax-rate is exceedingly wasteful. The greater part of the increased income that the State requires for improved social services should be got by raising the rates upon the high levels of income.

4. In order to make the income tax a completely effective instrument of public revenue, everything that rightly ranks as income should come under its survey. Before the war farmers' profits, assessed at the ridiculous amount of one-third of the rental, virtually escaped all taxation. Even now, though the ordinary basis of assessment has been raised to double the rental, prosperous farmers are in most instances undertaxed.

HOW TAXES ARE EVADED

During the war, many firms doing war-work were permitted to apply a large proportion of their profits to extensions and improvements which were not subjected to taxation. Though the large reserves which have been created by many lucrative businesses do not escape ordinary taxation, they escape super-tax by distribution under the head of "bonus shares." The great bulk of the gains made during the war by shipowners, from increases of the capital value of ships and compensation for lost ships, amounting in all to several hundreds of millions, wholly escaped taxation. The same applies to other large enhancements of capital values in agricultural lands, breweries and other values, which can be used as income by their owners, though they have paid no tax. Many large gains made by selling shares and other properties at enlarged war values have similarly escaped taxation by failing to figure in the income of any year.

THE TAX ON INHERITANCE

Though a reformed income tax will be the chief instrument of taxation, it needs to be supplemented by death duties which tap the capital wealth from time to time. For, though it may be feasible to get considerably more revenue by better progression of the tax on the higher levels of income, it is expedient that the income tax shall not be so heavy as to interfere with the saving of the classes that can afford to save. An income tax beyond a certain point might check production or saving, or both, and this under existing circumstances would be socially injurious. We have seen that a great deal of increase of wealth escapes taxation by not figuring as income. It can and should be heavily taxed when it passes at the death of the owner to persons who have certainly done nothing to create it.

War finance has done very little to exploit this source of revenue. For though the yield from income super-taxes was raised five-fold between 1914 and 1918, the yield from death duties was increased by no more than some fifteen per cent. A considerable increase of revenue should be obtainable from this source by a general raising of the tax and a sharper progression on the larger estates. Public opinion everywhere is favourable to this mode of raising revenue. It must, however, be remembered that though income tax and death duties are complementary, they are also substitutional, in the sense that a high income tax reduces the accumulation of property, while a high death duty reduces the subsequent income of the heirs and legatees.

INDIRECT TAXATION

Indirect taxes are generally bad, being secret and injurious in their incidence and expensive in collection. Having regard, however, to the necessary imperfection of any income-tax as a measure of ability to pay, I find a strong case for reinforcing it by a few taxes chiefly on luxuries. Foremost I would place an Inhabited House Tax, reconstructed, better graduated, and confined to dwellings where accommodation in space and number of rooms was more than adequate to the hygienic and other reasonable needs of the occupants. The existing licence duties upon motor-cars and carriages, men servants, game licences, and such other minor luxuries as armorial bearings, might be maintained and increased, though the total yield from such sources could not be large. A few of the licence duties of wider incidence, such as those on guns and dogs, might be retained, less for revenue than as checks upon unnecessary expenditure.

The only important indirect taxes, however, that an intelligent State would retain are those directed to the control and restraint of a few important popular luxuries, the large consumption of which is detrimental to personal health, morals, or public order. Alcoholic drinks and tobacco, in their present excessive use, may reasonably be taxed under this head.

The other indirect taxes, under the heads of Customs or Excise, Licence or Stamp Duties, should be removed as injurious interferences with liberty of life or commerce. The so-called "Breakfast Duties" upon tea, coffee, cocoa, sugar, &c., are an utterly indefensible secret assault upon the incomes of the poor.

THE CASE AGAINST TARIFFS

It is not practicable here to discuss at length the impudent attempt of certain business interests to raise prices and tax consumption by means of prohibitions and duties upon imports entering the country.* The endeavour to lay the foundations for a full protectionist policy by protection of "key industries" and war-made industries, anti-dumping regulations and imperial preferences, is not likely to be very successful at a time when everywhere supplies are short and prices high. But it is well to remember that any concessions to specious pleas of protection against "dumping" will put the consumers of this country at the mercy of the strongly established combines and trusts which are everywhere asserting their control of markets.

As a means of revenue, a tariff is the worst of instruments. It is very costly to collect and for every pound it brings to the revenue, it costs several pounds to the consumer, who pays a higher price, not on the imported goods only, but on the home-made goods as well. Nobody now advocates a tax upon imported foods and raw materials, in view of the world-shortage likely to exist for some years to come. But a tariff upon "wholly or mainly manufactured" goods would not yield more than a net twenty-seven millions (upon the corrected import values for 1913), even at a high average duty of twenty per cent. Nearly all of this would eventually be drawn from consumers, *i.e.*, from the real incomes of taxpayers in this country, and by raising prices would cause a reduction in the yield of direct taxes.

* See separate pamphlet, "*Tariffs and the Worker*," by Brougham Villiers, The Labour Party, 2d.

TAXES AND THE CAPITAL LEVY

In no way could the yield of a protectionist tariff make any substantial contribution to the great revenue our State requires for its post-war needs. If the nation is to find for next year a tax-revenue not far short of 1,000 millions, it will find it practically impossible to raise so large a sum by the methods of ordinary direct taxation here discussed, without recourse to an emergency levy. To load upon the ordinary expenditure a sum of at least £350 millions, for the service of the debt, would make a demand which the annual taxation cannot rightly bear. At least a half, and, if possible, three quarters, of this charge should be redeemed by a levy upon capital. Bad war-finance and profiteering have brought enormous accessions to the monetary wealth of the well-to-do classes. Sir J. C. Stamp, a leading official authority, conjectures that a net addition of £5,250 millions has been made during the war to the individual wealth which would be subject to a capital levy. This takes account of the falls in certain values and sets them off against the gains. It is impossible here to present even in a summarised form the arguments by which Mr. Pethick Lawrence in his book, "A Levy upon Capital," has established the feasibility and desirability of a levy. I would merely add that, even were the dangers and difficulties attending a levy graver than its opponents have shown to exist, it would still be better to confront and overcome them than to break down the ordinary taxing system by putting upon it a heavier burden than it can bear. Public finance stands to-day in a difficult position. Risks and dangers meet it whatever course is adopted. It is not an issue between high taxation and a capital levy. In no case can high taxation be avoided. The capital levy is necessary to prevent high taxation from becoming oppressive and impracticable.

SUMMARY OF RECOMMENDATIONS

Labour's policy in the sphere of Taxation, therefore, includes, besides the Capital Levy, the following essential proposals :—

1. Taxation must be based upon "ability to pay," that is, it should be levied upon the "surplus" beyond what is necessary to maintain a reasonable standard of life.
2. The main expedients should be the retention and development of income tax and death duties, with a higher exemption limit corresponding to the increased cost of living, and allowing to the worker a reasonable standard of life before taxation begins to be levied.
3. Allowances for expenses incurred on tools, travelling, clothes, &c., should be on a liberal scale, and trade union and "friendly" contributions should be exempt from taxation.
4. Family incomes should, for income tax purposes, be divided by the number of persons dependent upon them.
5. Allowances, abatements, &c., should be replaced by a single system of more steeply graduated taxation, and increased revenue should be secured by raising the rates on the larger incomes.
6. Everything that is really income should be liable to tax, and steps should be taken to defeat such methods of evading super-tax, &c., as the creation of bonus shares.
7. Death duties should be increased and the principle of resuming a large proportion of big accumulations at the death of their owner fully recognised.
8. Indirect taxation should be restricted to taxation on luxuries, and indirect taxation on necessaries should be abolished.
9. Tariffs, including specious attempts to protect so-called "key industries" and "dumping," should be opposed as taxes upon consumption, which place the consumer at the mercy of combines and trusts, and also because they are very costly to collect and involve huge waste, and, by increasing prices, cause a fall in the yield of direct taxes.

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